2003 PJM Annual Report

The Wave of Continuous Improvement

The Wave of Continuous Improvement

PJM Annual Report

PJM Interconnection at a glance

$6.9 billion in annual billings

63,762 megawatts of peak demand

348,700 gigawatt-hours of annual energy

20,762 miles of transmission lines

76,000 megawatts of installed generating capacity

More than 250 members

25 million people in all or parts of Delaware, Maryland, New Jersey, Ohio, Pennsylvania, Virginia, West Virginia and the District of Columbia

At PJM, continuous improvement is all about people, ideas and technology coming together in the quest for new and better solutions. Leading the way with reliable operations and efficient wholesale markets. Helping stakeholders reach their goals.

PJM ensures the safety, reliability and security of the electric power system serving 25 million people in seven states and the District of Columbia. PJM:

- **Coordinates and directs the operation of the region's transmission grid;**
- **Administers the world's largest competitive wholesale electricity spot market; and,**
- **Plans regional transmission expansion improvements to cost-effectively maintain grid reliability and relieve congestion.**

Message from the Board

John McNeely "Neel" Foster
Carolyn Smithson Burger
Lynn W. Eury
Howard Schneider, J.D.
John T. Coughlin, J.D.
Phillip G. Harris
Richard T. Lahey, Jr., Ph.D.
Frank L. Olson
Ake Almgren, Ph.D.
Jean D. Kinsey, Ph.D.

To PJM's Members, Stakeholders and Employees:

The Board of Managers of PJM Interconnection is generally pleased with the company's performance this past year – an eventful year that saw PJM weather the effects of the August 14 blackout in North America and the beginning of the integration of Commonwealth Edison into the PJM grid. Yet, as the independent guardians of PJM's performance, we are always mindful that PJM can do better. Toward that goal of heightened performance, we set standards and give guidance that we expect will make PJM a more productive and better-performing entity for the benefit of its members/customers, the regulatory bodies with which it interacts and the public that it serves.

Our mandate is to ensure the reliability and security of the bulk electrical supply system in the PJM region and to enhance the competitiveness of PJM's electricity markets. Our highest priority, of course, is the reliability of the electrical transmission system that powers the mid-Atlantic regional economy and affects the lives of its millions of inhabitants. PJM has performed, and must continue to perform, at the highest levels of reliability as it coordinates the movement of electricity throughout the region. PJM's Regional Transmission Expansion Planning Process, and the board's periodic review of that long-term plan, enable us to confirm that high standards of reliability and safety are attained and that necessary infrastructure is constructed to meet future needs.

Our mandate also is to ensure robust and competitive markets. PJM markets support reliability by providing incentives for buyers and sellers to supply energy and ancillary services to the grid, enabling them to respond swiftly and appropriately to changes in power needs. PJM's solid foundation of rules, knowledge and experience gives market participants confidence in PJM markets and, equally important, gives stakeholders confidence in the integrity of those markets.

The board is most keenly aware that confidence in PJM's integrity is fostered by the board's independence and neutrality. We believe that our independence and neutrality are exemplified by our autonomous actions over the years, all of which were intended to foster fair and impartial markets. We remain committed to PJM's continued development of the innovative and collaborative solutions that have marked its success to date. We are confident in the competence, professionalism and integrity of PJM employees. Together with its various constituencies, PJM is working to perfect the flow of energy.

PJM Board of Managers

Letter from the President

Phillip G. Harris

President & Chief Executive Officer

To Our Members, Stakeholders and Employees:

The philosophy of continuous improvement has driven the electricity industry since the days of Thomas Edison. Through most of the 20th century, the industry produced greater efficiencies, lower costs, improved reliability and, in due course, independent organizations such as PJM Interconnection to operate and oversee regional electric transmission systems. At PJM, the spirit of continuous improvement has been part of our corporate DNA since we were formed in 1927. While we were pleased with PJM's performance during the August 14 North American electricity outage and subsequent system restoration, PJM always looks for lessons learned to strengthen our ability to provide reliable grid operations.

Our commitments are straightforward: maintain the safe and reliable operation of the grid in the PJM region; create and operate robust, competitive and nondiscriminatory electric power markets in our region; and maintain the principle that no member or group of members shall have undue influence over the operation of PJM. Continuous improvement and productivity are how we achieve those goals.

Our nation needs strong regional coordination of the electric transmission grid. For 100 years the interconnected transmission system was planned, built and operated by more than 4,000 different entities functioning more or less independently from each other. However, the Eastern Interconnection's needs evolved beyond the limits of individual companies' self-optimizing just their portion of the grid.

Effective coordination is facilitated when fewer operators, responsible for larger geographic footprints, govern dispatching and scheduling decisions; when transparent regional transmission planning provides inclusive solutions among competing alternatives; and when there is a competitive, liquid wholesale market. Fully functioning regional transmission organizations (RTOs) such as PJM overcome the limitations resulting from the historic balkanization of the system.

One cannot separate wholesale electricity markets from reliability. The discipline of our markets enforces reliability more effectively than mandatory rules or penalties. PJM has experienced how a competitive price for power – derived honestly from bids of willing buyers and sellers – actually enhances reliability. Our market design incorporates constraint conditions in its price signals. Therefore, the prices produced reflect the actual physical state of the grid. Market participants' economic incentives are then aligned with reliable operations. Observed over time, these price signals form a clear basis for performing regional planning.

Regional planning, in fact, plays a significant role in ensuring the reliability of the grid. PJM was the first RTO to implement a Regional Transmission Expansion Planning Process that requires facilities to be put into service to maintain reliability. An independent entity with a "big picture" look at the entire grid and a transparent process can ensure that the appropriate hardware is in place to support reliability. Through 2003, transmission investments approved under the PJM planning process totaled nearly $685 million. Those investments will accommodate the interconnection of 25,000 megawatts of generating capacity.

In operations, we made technology improvements in 2003 that expanded our ability to determine the status of the real-time transmission system. All of these improvements increased reliability. Throughout the year, PJM continued to put into place the systems necessary to integrate additional utilities into PJM. We ended 2003 technologically and operationally ready to bring the benefits of competitive wholesale electricity markets to regions slated to join PJM.

The markets we operate have experienced tremendous growth, but PJM's productivity has kept pace. For example, total annual billings have grown from less than $1 billion in 1998 to nearly $7 billion in 2003. During that time, our administrative costs, as a percentage of billings, have declined by half.

Though PJM's model of grid operations continues to earn praise, we know that we can improve. PJM strives to anticipate our stakeholders' requirements and to arrive at collaborative solutions. PJM is dedicated to ensuring that our vision, mission and business strategy align with customers' requirements. Together, we're working to perfect the flow of energy.

President & Chief Executive Officer

Continuous Reliability

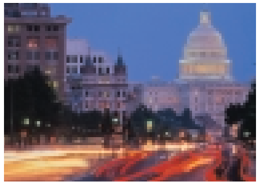
Encouraging peak performance. Markets create economic incentives for generators to be ready to run whenever called upon – a critical key to maintaining system reliability. Since 1998, there has been a 20 percent reduction in the periods when generating units were not available when called upon.

PJM coordinates the regional electric power grid and administers the wholesale electricity market. We meet the highest standards of system reliability, while providing access to wholesale power at the best available price. At the same time, we plan for the future so that the electric transmission system will be ready to meet consumers' growing use of electricity.

The grid. PJM operates the grid of high-voltage transmission lines within all or parts of seven states and the District of Columbia – from Ohio to New Jersey. Operating the regional grid as one entity, regardless of the many different owners of the separate parts of the system, gives PJM a broad view of grid events and the system's status. That means we react quickly to any situation that might jeopardize the steady supply of electricity.

The markets. PJM administers a competitive marketplace that brings together buyers and sellers of wholesale electricity and related energy services. PJM provides real-time information to market participants that allows them to respond to changes in the power supply and grid conditions. PJM takes data that was once available only to utilities and turns it into useful information instantly available to all. The results ensure a consistently reliable and economical supply of electricity.

The future. PJM's Regional Transmission Expansion Process plans, develops and maintains a reliable electric power system for the future. It is the first regional planning process in the country that objectively evaluates generation interconnections and the need for reliability upgrades, actively involves stakeholders and mandates necessary grid improvements. Transmission investments approved under the PJM plan total nearly $685 million since 2000 throughout the PJM region.



Monitoring and improving reliability has been our primary goal for more than 75 years. Twenty-five million people count on PJM to make sure that electricity is available whenever they need it. They may not know us, but we touch their lives every minute of every day.

Continuous Efficiency

Giving customers more options. Sometimes the most economic source of electricity is the megawatt that is not used. PJM provides incentives for large electricity buyers to reduce their purchases based on the price of wholesale electricity. Demand-response programs include nearly 1,400 megawatts of reducible demand in PJM. Despite lower usage levels in the summer of 2003, PJM's economic demand-response program produced $9 million in market price benefits by reducing the market clearing price.

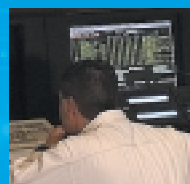
Competitive markets lead to fair prices. PJM's spot Energy Market, introduced in 1997, allows participants to buy and sell electricity in an open, transparent process. Generators make competitive offers to supply wholesale electricity. The offers are accepted, beginning with the lowest price, until the generating supply meets the demand for electricity. Today, utilities and competitive suppliers rely on PJM's efficient, liquid Energy Market to obtain 40 percent of the electricity used in the region.

Market efficiency improves with a larger number of competitors and centrally coordinated dispatch over a larger geographic region. PJM operates the world's largest wholesale electricity market and the largest control area in North America. Future integration of new regions into the PJM marketplace should create greater efficiencies. For example, the addition in 2002 of Allegheny Power's system to PJM created estimated savings of more than $100 million to wholesale customers in the expanded PJM region as the result of efficient dispatch of low-cost electricity.

Markets operate best when buyers and sellers have easy and continuous access to information about prices. PJM transforms millions of bytes of raw data per minute into the usable information customers need to make educated decisions. During 2003, PJM made this real-time grid and market data universally available by presenting it free of charge on the eData service of PJM's Web site, with no registration or password required.

Efficiency means getting a job done with a minimum of expense or unnecessary effort. We provide customers increasingly efficient business solutions through centralized dispatch and competitive markets for wholesale electricity.

Continuous Productivity



Providing the tools. A new, two-story array of video monitors for the control room is replacing an old, static grid map and giving dispatchers a dynamic view of the system. They will be able to literally display a big picture – and to zoom in for a detailed view – of all the transmission system data currently available on smaller computer monitors.

PJM people always look for even better ways of working. In 2003, PJM turned its attention to the heart of our operations – the control room – beginning a methodical, multiyear redesign process. This process will streamline both the facilities and the workflow at our current control room and prepare PJM for the future.

PJM began by looking at other industries where security and reliability are absolute requirements and examining how they structure their operations for maximum productivity. The air traffic control, nuclear and telecommunications work environments provided many best practices for constant preparedness and flexibility.

Next, PJM analyzed all control room tasks and functions and reassessed how to structure jobs for even greater productivity. As a result, PJM is reorganizing control room staff into teams that will rotate through different functions on a regular basis.

Implementing new control room solutions and initiating training on change management are preparing PJM for its future. Our goal is to anticipate and prepare for tomorrow's needs so that change happens smoothly and productivity levels continue to grow.

Continuously improving the productivity of our organization minimizes costs and increases value for our members.

As of December 31, 2003

A
Accent Energy New Jersey LLC
ACN Energy Inc
ACN Power, Inc.
Advantage Energy, Inc.
AES Enterprise, Inc.
AES Ironwood, LLC
AES Red Oak, LLC
AIG Energy Trading, Inc.
Air Products & Chemicals, Inc.
Allegheny Electric Cooperative, Inc.
Allegheny Energy Supply Company, LLC
Allegheny Energy Supply Conemaugh, LLC
Allegheny Power
Amerada Hess Corporation
AmerGen Energy Company, LLC
American Cooperative Services, Inc.
American Municipal Power-Ohio, Inc.
American Ref-Fuel Company of Delaware Valley, LP
American Ref-Fuel Company of Essex County
American Transmission Systems, Inc.
Appalachian Power Company
Aquila Merchant Services, Inc.
Armstrong Energy Limited Partnership, LLLP
Atlantic City Electric Company
Automated Power Exchange, Inc.

B
Baltimore Gas and Electric Company
Bank of America, NA
Benton Foundry, Inc.
BGE Home Products & Services, Inc.
Black Oak Capital, LLC
Black Oak Energy, LLC
BOC Energy Services, Inc.
BOC Group, Inc. (The)
Borough of Chambersburg
Borough of Ephrata
Borough of Mont Alto
Borough of Tarentum
BP Energy Company
Buckeye Power, Inc.

C
Calpine Energy Services, LP
Calvert Cliffs Nuclear Power Plant, Inc.
CAM Energy Products, LP
Cargill Power Markets, LLC
Carolina Power & Light Company
Carpenter Technology Corporation
Central Power & Light Company
Cincinnati Gas and Electric Company (The)
Cinergy Capital & Trading, Inc.
Cinergy Services, Inc.
Citadel Energy Products, LLC
City of New Martinsville - WV
City of Philippi - West VA
CMS Marketing, Services and Trading Company
Columbia Energy Power Marketing Corporation
Columbus Southern Power Company
Commercial Utility Consultants, Inc.
Commonwealth Chesapeake Company, LLC
Commonwealth Energy Corporation dba electricAMERICA
Conectiv Energy Supply, Inc.
Con Edison Energy, Inc.
ConocoPhillips Company
Consolidated Edison Company of New York, Inc.
Consolidated Edison Solutions, Inc.
Constellation Energy Source, Inc.
Constellation NewEnergy, Inc.
Constellation Power Source Generation, Inc.
Constellation Power Source, Inc.
Continental Cooperative Services
Coral Power, LLC
Covanta Energy Group, Inc.
Covanta Union, Inc.
Customized Energy Solutions, Ltd

D
Dayton Power & Light Company
DC Energy LLC
Delaware Municipal Electric Corporation
Delmarva Power & Light Company
D.E. Shaw Plasma Power, LLC
Detroit Edison Company
Division of the Public Advocate of State of Delaware
Dominion Energy Marketing, Inc.
Dominion Retail, Inc.
Dominion Virginia Power
Downes Associates, Inc.
DTE Energy Marketing, Inc.
DTE Energy Trading, Inc.
Duke Energy Fayette, LLC
Duke Energy Marketing America, LLC
Duke Energy Trading and Marketing, LLC
Duke Power Company
Dynegy Energy Services, Inc.
Dynegy Power Marketing, Inc.

E
East Coast Power Linden Holdings, LLC
Easton Utilities Commission
ECONnergy Energy Company, Inc.
ECONnergy PA, Inc.
Edison Mission Marketing & Trading, Inc.
E.F. Kenilworth, Inc.
El Paso Merchant Energy, LP
EME Homer City Generation, LP
Energy Analytics
Energy Authority, Inc. (The)

Energy Cooperative Association of Pennsylvania
Energy East Solutions, Inc.
Enerwise Global Technologies, Inc.
Engage Energy America, LLC
Entergy-Koch Trading, LP
EPEX, Inc.
Entegra Capital Management, LP
EPIC Merchant Energy, LP
Exelon Generation Company, LLC
F Fairless Energy, LLC
FirstEnergy Solutions Corp.
Florida Power & Light Company
Florida Power Corporation dba Progress Energy Florida, Inc.
FMF Energy, Inc.
FPL Energy Power Marketing, Inc.
G Galt Power, Inc.
Green Mountain Energy Company
H Hagerstown Light Department
Handsome Lake Energy, LLC
Harrison REA, Inc. - Clarkesburg, WV
HC Power Marketing, LLC
Hess Energy, Inc.
H.Q. Energy Services (U.S.), Inc.
I Illinois Municipal Electric Agency
Indiana Michigan Power Company
ISG Sparrows Point, LLC
It's Electric & Gas, LLC
J J. Aron & Company
Jersey Central Power & Light Company
K Kentucky Power Company
KeySpan Energy Services, Inc.
KeySpan - Ravenswood, LLC
L Lebanon Methane Recovery, Inc.
Lehigh Portland Cement Company
Letterkenny Industrial Development Authority - PA
Liberty Electric Power, LLC
Liberty Power Corp., LLC
Lower Mount Bethel Energy, LLC
M Mack Oil Company dba Mack Services Group (The)
Marina Energy, LLC
Marquette Energy, LLC
Maryland Office of People's Counsel
Maryland Public Service Commission
Merrill Lynch Capital Services, Inc.
Metropolitan Edison Company
MG Industries
MidAmerican Energy Company
Middlesex Generating Co., LLC
Midwest Generation Energy Services, LLC
MIECO, Inc.
Mirant Americas Energy Marketing, LP
Mirant Americas Retail Energy Marketing, LP
Mirant Potomac River, LLC
Monongahela Power Company
Morgan Stanley Capital Group, Inc.
Mt. Carmel Cogeneration, Inc.
N New Jersey Division of the Ratepayer Advocate
New York State Electric & Gas Corporation
NJR Natural Energy Company
North Carolina Electric Membership Corporation
Northeast Utilities Service Company
Northern States Power Company
NRG New Jersey Energy Sales, LLC
NRG Power Marketing, Inc.
NUI Energy Brokers, Inc.
NYSEG Solutions, Inc.
O Occidental Power Marketing, LP
Occidental Power Services, Inc.
Ocean Peaking Power, LLC
Office of the People's Counsel for the District of Columbia
Ohio Power Company
Old Dominion Electric Cooperative
Orion Power Midwest, LP
Outback Power Marketing, Inc.
P Panda Power Corporation
PECO Energy Company
PEI Power Corporation
PEI Power II, LLC
Penn Power Energy, Inc.
Pennsylvania Electric Company
Pennsylvania Office of Consumer Advocate
Pepco Energy Services, Inc.
PG Energy Services, Inc. dba PG Energy PowerPlus
Pleasants Energy, LLC
Potomac Edison Company (The)
Potomac Electric Power Company
Potomac Power Resources, Inc.
Powerex Corporation
PPL Brunner Island, LLC
PPL Electric Utilities Corporation dba PPL Utilities
PPL EnergyPlus, LLC
PPL Holtwood, LLC
PPL Martins Creek, LLC
PPL Montour, LLC
PPL Susquehanna, LLC
Praxair, Inc.
Progress Energy Ventures, Inc.
PSE&G Energy Resources & Trade, LLC
PSI Energy, Inc.
Public Service Company of Oklahoma
Public Service Electric and Gas Company

Energy Cooperative Association of Pennsylvania
Energy East Solutions, Inc.
Enerwise Global Technologies, Inc.
Engage Energy America, LLC
Entergy-Koch Trading, LP
EPEX, Inc.
Entegra Capital Management, LP
EPIC Merchant Energy, LP
Exelon Generation Company, LLC
F Fairless Energy, LLC
FirstEnergy Solutions Corp.
Florida Power & Light Company
Florida Power Corporation dba Progress Energy Florida, Inc.
FMF Energy, Inc.
FPL Energy Power Marketing, Inc.
G Galt Power, Inc.
Green Mountain Energy Company
H Hagerstown Light Department
Handsome Lake Energy, LLC
Harrison REA, Inc. - Clarkesburg, WV
HC Power Marketing, LLC
Hess Energy, Inc.
H.Q. Energy Services (U.S.), Inc.
I Illinois Municipal Electric Agency
Indiana Michigan Power Company
ISG Sparrows Point, LLC
It's Electric & Gas, LLC
J J. Aron & Company
Jersey Central Power & Light Company
K Kentucky Power Company
KeySpan Energy Services, Inc.
KeySpan - Ravenswood, LLC
L Lebanon Methane Recovery, Inc.
Lehigh Portland Cement Company
Letterkenny Industrial Development Authority - PA
Liberty Electric Power, LLC
Liberty Power Corp., LLC
Lower Mount Bethel Energy, LLC
M Mack Oil Company dba Mack Services Group (The)
Marina Energy, LLC
Marquette Energy, LLC
Maryland Office of People's Counsel
Maryland Public Service Commission
Merrill Lynch Capital Services, Inc.
Metropolitan Edison Company
MG Industries
MidAmerican Energy Company
Middlesex Generating Co., LLC
Midwest Generation Energy Services, LLC
MIECO, Inc.
Mirant Americas Energy Marketing, LP
Mirant Americas Retail Energy Marketing, LP
Mirant Potomac River, LLC
Monongahela Power Company
Morgan Stanley Capital Group, Inc.
Mt. Carmel Cogeneration, Inc.
N New Jersey Division of the Ratepayer Advocate
New York State Electric & Gas Corporation
NJR Natural Energy Company
North Carolina Electric Membership Corporation
Northeast Utilities Service Company
Northern States Power Company
NRG New Jersey Energy Sales, LLC
NRG Power Marketing, Inc.
NUI Energy Brokers, Inc.
NYSEG Solutions, Inc.
Q Quark Power, LLC
R Rainbow Energy Marketing Corporation
Rainy River Energy Corporation
RAM Energy Products, LLC
Reliant Energy Hunterstown, LLC
Reliant Energy Services, Inc.
Reliant Energy Solutions East, LLC
RMKG, LLC
Rochester Gas and Electric Corporation
Rockland Electric Company
RWE Trading Americas, Inc.
S Safe Harbor Water Power Corporation
Schuylkill Energy Resources, Inc.
Select Energy, Inc.
Select Energy New York, Inc.
Sempra Energy Solutions
Sempra Energy Trading Corporation
Sesco Enterprises, LLC
Sheetz, Inc.
Sithe Power Marketing, LP
South Carolina Electric & Gas Company
Southern Maryland Electric Cooperative, Inc.
South Jersey Energy Company
South Jersey Energy Solutions, LLC
Southwestern Electric Power Company
Split Rock Energy, LLC
STI Capital Company
Strategic Energy, LLC
Sunbury Generation, LLC
Sunoco, Inc. (R&M)
Sunoco Power Marketing, LLC
Susquehanna Energy Products, LLC

T Target Corporation
TEC Trading, Inc.
Tenaska Power Services Co.
Thurmont Municipal Light Company
Town of Front Royal, Virginia
Town of Williamsport
Tractebel Energy Marketing, Inc.
Tractebel Energy Services, Inc.
TransAlta Energy Marketing (US), Inc.
TXU Pedricktown Cogeneration Company, LP
TXU Pedricktown Retail Company, LLC
TXU Portfolio Management Company, LP
U UBS AG, acting through its London Branch
UGI Development Company
UGI Energy Services, Inc.
UGI Utilities, Inc.
Upper Peninsula Power Company
USP&G (Pennsylvania), Ltd.
UtiliTech, Inc.
V Vineland Cogeneration Limited Partnership
Vineland Municipal Electric Utility
Virginia State Corporation Commission
W Wabash Valley Power Association, Inc.
Washington Gas Energy Services, Inc.
Wellsboro Electric Company
West Penn Power dba Allegheny Power
West Texas Utilities Company
Weyerhaeuser Company
Williams Generation Company - Hazelton
Williams Power Company, Inc.
Wisconsin Public Service Corporation
WPS Energy Services, Inc.
WPS Westwood Generations, LLC

Continuous Innovation

Creating better experts. Computerized "expert systems" can rapidly analyze large sets of data to augment human decision making. PJM's first expert system functions as a "digital consultant" to dispatchers. When an abnormal condition is detected, the system suggests possible causes and courses of corrective action.

PJM builds value by matching leading-edge solutions to the needs of our customers. Planning is key to harnessing new technologies early, successfully and cost-effectively. During 2003, we initiated a strategic planning process for information technology.

Identifying the best options. In December 2003, PJM installed one of the largest, most thorough "state estimator" computer programs. The system gives PJM operators the status of nearly a third of the Eastern Interconnection, which consists of most of the North American transmission and generation systems east of the Rocky Mountains. Using both real-time and estimated data from a mathematical model, PJM creates a view of the state of the transmission grid. With this view PJM can examine approximately 3,000 "what if" scenarios – possible outages of critical facilities within PJM or neighboring control areas. Then, PJM can determine what actions it must take to be prepared.

Improving communication. PJM also is working with other regional grid operators to standardize data exchange. For example, a new feature, currently under development, would automate the sharing of information about scheduled power flows between PJM and a neighboring control area, reducing the number of phone calls required between control areas to coordinate transactions.

PJM seeks to ride ahead of the wave of innovation in the electric industry. As an information company, our systems distill enormous amounts of raw data into usable formats that augment human expertise.


pjm
Current PJM RTO Load: 42,663MW
PJM members
My eData Preferences
Guest1
eData
Price in US$
PJM (Zone)
39.40
26.70
44.59
LMP Chart
Into PJM
1,632
190
-415
2,876
4,283
Out of PJM
Scheduled
Tie Flows
PJM Tie Flows
MegaWatts

Independent governance. Even though the Board of Managers is accountable to PJM members, the board acts independently to promote innovative solutions and curb potential market abuse. When appropriate, the board can ask the Federal Energy Regulatory Commission to revise the PJM tariff, Operating Agreement or the Reliability Assurance Agreement.

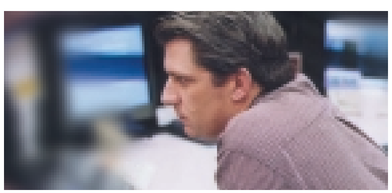
PJM's organizational structure ensures our fundamental fairness to all stakeholders and prevents the abuse of power by any one party or group of stakeholders.

The Board of Managers. PJM's highest governing body is the Board of Managers. Members of the board – like all PJM employees – have no affiliation with or financial stake in any PJM market participant. The board is responsible for overseeing that PJM:

- maintains the safe and reliable operation of the PJM region;
- creates and operates robust, competitive and nondiscriminatory electric power markets in the PJM region; and,
- upholds the principle that a member or group of members shall not have undue influence over the operation of the PJM region.

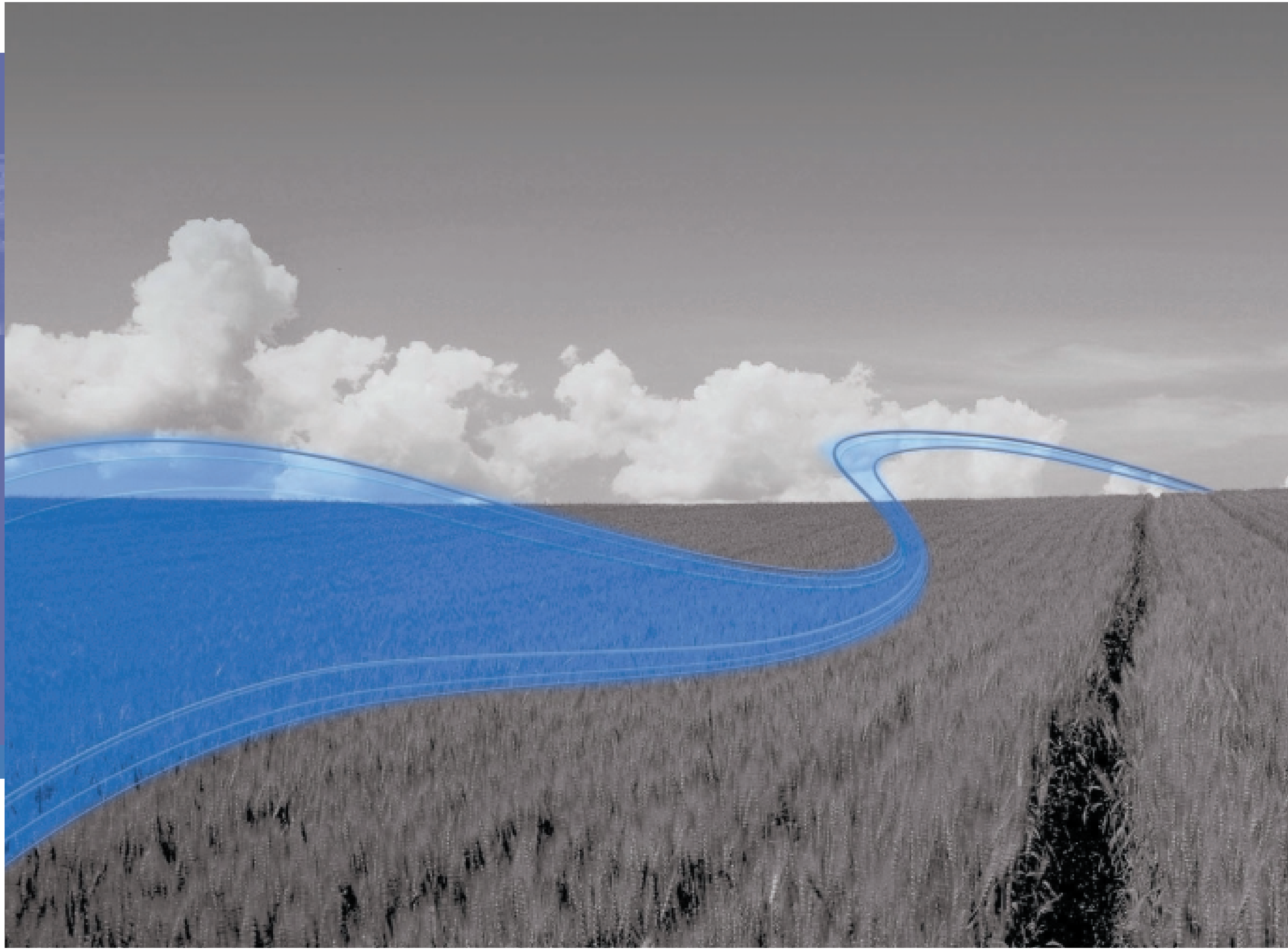
The Members Committee. Organizations and companies that use PJM's services join PJM as members. They are both our customers and our owners, and each PJM member has a representative on the Members Committee. It proposes and votes on changes in market rules and new programs, makes specific recommendations to the board and elects the board members.

The Market Monitoring Unit (MMU). The MMU is an independent group within PJM. The MMU assesses the state of competition in each of the markets operated by PJM, identifies specific market issues and recommends potential enhancements to improve the competitiveness and efficiency of the markets. In particular, the MMU is responsible for monitoring the compliance of members with PJM's market rules and for evaluating PJM's policies to ensure those rules remain consistent with the operation of a competitive market.



Integrity is our guiding principle. By scrupulously maintaining our independence and neutrality, PJM safeguards the trust of all of our stakeholders.

Continuous Collaboration



Facilitating wind power. In 2003, a working group of PJM members collaborated on new rules that allow wind power to compete on an equal basis with more traditional electric generators. The rule change enables wind generators to receive capacity credits. The sale of the capacity credits provides another source of income to the generators.

PJM works with stakeholders to resolve their needs and to create and maintain a fair, reliable and economic electric system and electricity market. PJM's culture of collaboration encourages stakeholders to find compromise and solutions. We provide a forum for working out multistate issues.

Better interregional cooperation. A landmark step in 2003 showed how PJM's collaborative approach can extend beyond our borders. PJM and the Midwest ISO signed a joint operating agreement (JOA). The JOA provides for unprecedented coordination between PJM and the Midwest ISO. It envisions real-time data sharing and protocols for responding to conditions on the neighboring system. This comprehensive agreement could serve as a template for coordination throughout the industry.

Improved stakeholder collaboration. On an organizational level, PJM assembled an advisory team to recommend ways to enhance the collaborative culture at PJM. The team's recommendations reaffirmed the Members Committee as PJM's central forum for resolving difficult issues through active discussion and negotiation. A number of improvements were suggested, including:

- Reducing the number of committees that report to the Members Committee;
- Establishing committee bylaws;
- Implementing an annual planning procedure; and,
- Introducing an online issues tracking mechanism.

PJM's collaborative approach empowers the community of stakeholders to achieve results that meet their differing goals.

Ake Almgren, Ph.D.

Member, Finance, Human Resources and Reliability Committees

For more than 20 years, Dr. Almgren has led business entities providing electric equipment and systems. He retired in 2003 as president and CEO of Capstone Turbine Corp. and now heads his own consulting company, Orkas Corp. Before joining Capstone in 1998, he was president of several ABB subsidiaries involved in power transmission and distribution.

Carolyn Smithson Burger

Member, Audit, Finance and Reliability Committees

Ms. Burger heads her own consulting firm, CB Associates, which she formed in 1996. She previously served as president and chief executive officer of Bell Atlantic-Delaware after having served as vice president, secretary and treasurer of Bell Atlantic Corp. She is one of the few women in the United States ever to head an operating telephone company.

John T. Coughlin, J.D.

Member, Competitive Markets, Governance, Human Resources and Nominating Committees

Mr. Coughlin is a professional mediator and arbitrator of electric utility industry disputes and labor-relations conflicts. He was the first chair of PJM's Board of Managers. Previously, he was a commissioner on the Wisconsin Public Service Commission and represented the National Association of Regulatory Utility Commissioners to the North American Electric Reliability Council. He also served as Wisconsin's secretary of labor. He is beginning his third year on the board of the Western Electricity Coordinating Council.

Lynn W. Eury

Chair, Human Resources Committee; Member, Reliability Committee

Mr. Eury, an engineering and management consultant, retired in 1994 as executive vice president and director of Carolina Power & Light Co. His work there involved assignments in generation, transmission and distribution. He was responsible for the planning studies for the utility's first 500-kilovolt transmission network.

John McNeely "Neel" Foster

Chair, Audit Committee; Member, Competitive Markets Committee

Mr. Foster is a former member of the Financial Accounting Standards Board, the standards-setting body for financial accounting and reporting, on which he served for 10 years. A certified public accountant, he previously was vice president, treasurer and principal accounting officer of the former Compaq Computer Corp. and senior audit manager with PricewaterhouseCoopers LLP (formerly Price Waterhouse & Co.).

Phillip G. Harris

Chair, Board of Managers

Mr. Harris is president and chief executive officer of PJM and chair of the Board of Managers. He has served in executive positions in generation, transmission and finance. He has served on the boards of directors of the Southwest Power Pool and the Southwest Resource Association. He serves as vice chair of the Administrative Board of the Mid-Atlantic Area Council and on the Advisory Committee of the National Association of Corporate Directors.

Jean D. Kinsey, Ph.D.

Member, Audit, Competitive Markets and Nominating Committees

Since 1976, Dr. Kinsey has been a faculty member in the Department of Applied Economics at the University of Minnesota, where she is co-director of The Food Industry Center. From 1996 to 1997, she chaired the board of the Federal Reserve Bank of Minneapolis. She is a Distinguished Fellow of both the American Council on Consumer Interests and of the American Agricultural Economics Association.

Richard T. Lahey, Jr., Ph.D.

Chair, Reliability Committee; Member, Audit Committee

Dr. Lahey is the Edward E. Hood Professor of Engineering at Rensselaer Polytechnic Institute. Prior to joining the Rensselaer faculty and administration, he held numerous technical and managerial positions with General Electric Co. An international authority on nuclear reactor safety technology, he has more than 40 years of industrial/academic experience in the application of advanced technology to practical problems.

Frank L. Olson

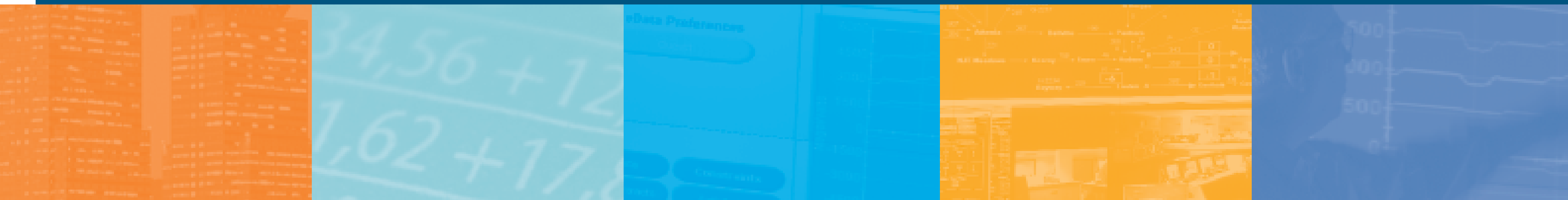
Member, Competitive Markets and Human Resources Committees

Mr. Olson is the former president and general manager of the Municipal Electric Authority of Georgia (MEAG Power), the nonprofit power supplier of wholesale electricity to 48 Georgia municipal utilities. At MEAG Power, he was jointly instrumental in the formation of The Electric Authority, the wholesale power-marketing arm for Santee Cooper, Jacksonville Electric Authority and MEAG Power.

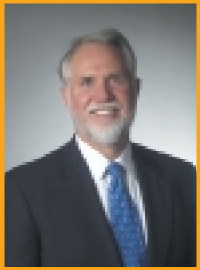
Howard Schneider, J.D.

Chair, Competitive Markets Committee; Chair, Nominating Committee; Member, Audit and Governance Committees

Mr. Schneider is a partner at Katten Mutchin Zavis Rosenman. He concentrates on corporate, securities and derivatives/futures law. He is the former chair of the American Bar Association Committee on Regulation of Futures and Derivative Instruments. He served as the first General Counsel of the Commodity Futures Trading Commission from 1975 to 1977.

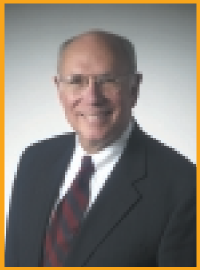


PJM Officers

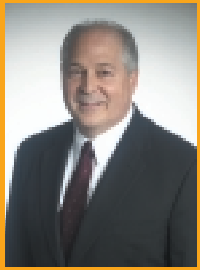


Phillip G. Harris
President and Chief Executive Officer

Jose Fuentes
Vice President and Chief Financial Officer



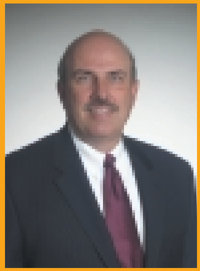
F. John Hagele
Vice President and General Counsel



Kenneth W. Laughlin
Vice President – Market Services

Toby S. Mannheimer
Vice President – Corporate Services

Alain P. Steven
Vice President and Chief Technology Officer

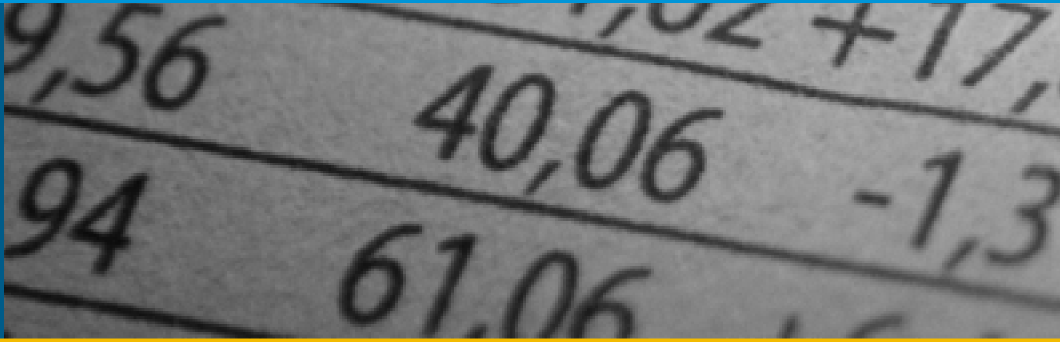


Richard A. Wodyka
Senior Vice President – Transmission

Audrey A. Zibelman
Executive Vice President

Working to Perfect the Flow of Energy

For information please contact: 866.400.8980 www.pjm.com



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PJM 2003 Financial Review

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Forward-Looking Statements

In addition to the historical information contained throughout this report, there are forward-looking statements that reflect management's expectations for the future. Sometimes the words *estimate*, *plan*, *expect* and *believe*, or similar expressions will be used to identify such forward-looking statements. These forward-looking statements are based on current expectations. These statements are not guarantees of future performance and are subject to certain risks and uncertainties.

Many factors could cause actual results to differ materially from these statements. These factors include, but are not limited to, the results of regulatory proceedings, the conditions of the capital markets, interest rates, availability of credit, liquidity, general economic conditions, changes in accounting principles and practices, acts of terrorists, the actions of adjacent control areas and other regional transmission organizations (RTOs), and other operational conditions that could arise on the power system. For a description of these and other factors that may cause actual results to differ, reference is made hereby to PJM's Consolidated Financial Statements, Notes thereto and other documents filed by the Company from time to time with the Federal Energy Regulatory Commission (FERC).

These forward-looking statements represent PJM's estimates and assumptions only as of the date of this report, and PJM assumes no responsibility to update these forward-looking statements.

Results of Operations for 2003, 2002 and 2001

Overview

PJM Interconnection, L.L.C. (PJM or Company) is responsible for the operation of wholesale electric markets and for centrally dispatching electric systems in the PJM region. The FERC issued an order on December 19, 2002, ruling PJM qualified for full RTO status and designating PJM as the sole RTO for the PJM region. PJM's services and the markets it operates are subject to regulation by the FERC.

PJM is a limited liability, non-stock company incorporated in the state of Delaware. PJM's Board of Managers is constituted as an independent body, and PJM operates independently from its members.

The Company currently coordinates a pooled generating capacity of more than 76,000 megawatts and operates a wholesale electricity market with more than 250 market buyers, sellers and traders of electricity. PJM enables the delivery of electric power to more than 25 million people in all or parts of Delaware, Maryland, New Jersey, Ohio, Pennsylvania, Virginia, West Virginia and the District of Columbia. Generating facilities in the PJM control area are diverse, including coal, oil and gas-fired units, nuclear plants and hydroelectric facilities. PJM also is dedicated to meeting the reliability standards of the North American Electric Reliability Council (NERC), the Mid-Atlantic Area Council (MAAC) and the East Central Area Reliability Council (ECAR).

PJM Technologies, Inc. (PJM Tech) is a wholly owned subsidiary of PJM and is not a FERC-regulated entity. PJM Tech was formed to provide service and technology solutions pioneered by PJM to existing and emerging energy markets, system operators and regional transmission organizations.

On March 14, 2001, PJM entered into agreements with Allegheny Power, the energy delivery business of Allegheny Energy, Inc., to develop a new electric transmission system affiliation that expanded PJM's existing region to the west. Operations in the PJM Western Region commenced April 1, 2002.

On August 14, 2001, Duquesne Light Company (Duquesne) announced its intention to join the PJM Western Region arrangements during 2002. During the third quarter of 2002, Duquesne announced it planned to defer a final decision on joining an RTO until it completed analysis of the FERC's proposed order on standard market design. On December 9, 2003, Duquesne filed a plan before the Pennsylvania Public Utility Commission expressing its intent to join PJM by January 1, 2005.

On January 21, 2002, PJM and the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) announced an executed letter of intent to develop a joint and common market for electricity producers and consumers in all or part of 22 Midwest and Mid-Atlantic states, the District of Columbia and the Canadian province of Manitoba.

On May 13, 2002, PJM and the Midwest ISO executed a memorandum of cooperation (MOC) to facilitate the implementation of a joint and common market in the Midwest. The MOC outlines a collaborative process to identify and address issues that will allow for a more efficient transition to a joint and common energy market. The market is being developed through an open stakeholder process and is being designed to serve residents whether they reside in states with bundled or unbundled retail rates.

In June 2002, American Electric Power (AEP); Commonwealth Edison (ComEd), a subsidiary of Exelon Corporation; Dayton Power & Light Company (DPL); and Illinois Power, a subsidiary of Dynegy, announced their intent to join PJM as an extension of the PJM Western Region, subject to regulatory approvals. Illinois Power no longer intends to join PJM.

In June 2002, Dominion Virginia Power (DVP) and PJM announced that the companies had executed an agreement to have Dominion's transmission lines operated on a regional basis by PJM. During the first quarter of 2003, the Virginia Legislature passed a law barring Virginia utilities, which include AEP and DVP, from turning over control of their transmission lines to RTOs before July 1, 2004, but requiring them to transfer control of their transmission lines to a "regional entity" by January 1, 2005, subject to the approval of the Virginia State Corporation Commission. AEP also requires approval from the Indiana Utility Regulatory Commission and the Kentucky Public Service Commission.

On November 25, 2003, the FERC issued an order preliminarily finding that Kentucky and Virginia state laws or regulations are preventing AEP from joining PJM and should be preempted. The FERC ordered an expedited evidentiary hearing, with an initial decision due by March 31, 2004, on this issue.

On July 31, 2002, the FERC conditionally approved the requests of AEP, ComEd, DPL and DVP (collectively, the market integration participants) to join PJM. The FERC's conditions for joining include resolution of certain operational and transmission rate matters to be approved by the FERC prior to the market integration participants' entry into PJM.

Implementation agreements were executed during October 2002 with the market integration participants. These agreements express the companies' plans for their phased integration into PJM's operations and markets, subject to certain regulatory approvals. As of December 31, 2003, PJM had capitalized $46 million in costs associated with the addition of the market integration participants. All integration expenses will be borne by the market integration participants. PJM's annual operating expenses are estimated to increase $75 million – $100 million after the addition of all market integration participants.

On April 16, 2003, the Midwest ISO, PJM and the Tennessee Valley Authority (TVA) announced plans to pursue the development of a multiregional approach to strengthen electric transmission, operations and related transactions. The memorandum of understanding executed by the three organizations initiates the first step of a process that would, when complete, facilitate a transparent market for a significant portion of the Eastern Interconnection. The Eastern Interconnection refers to North America's electric system east of the Rocky Mountains, excluding Texas.

In June 2003, PJM began providing third-party administrative services dealing with transmission functions under the existing ComEd and DPL Open Access Transmission Tariffs.

On December 31, 2003, the Midwest ISO and PJM executed and filed a joint operating agreement with the FERC. The agreement is the foundation by which the Midwest ISO and PJM will create seamless operations to serve wholesale electricity customers in 22 states, the District of Columbia and parts of Canada. The agreement is expected to improve coordination of interregional congestion management, operational data exchange, real-time communications, emergency protocols, system planning and market monitoring.

On December 31, 2003, PJM requested that the FERC approve May 1, 2004, as ComEd's integration date. PJM also continues to work toward market integration commencing on October 1, 2004, for AEP and DPL and November 1, 2004, for DVP.

On March 18, 2004, the FERC issued four orders in response to PJM filings seeking to meet previously established FERC conditions necessary to accommodate ComEd's integration into PJM. These orders conditionally approved most elements required to implement ComEd's integration. The commission, however, directed certain other actions to occur prior to integration. Principal among such actions are: (1) the North American Reliability Council's approval of the reliability plans of PJM and Midwest ISO; (2) the filing of revisions to the Joint Operating Agreement between PJM and MISO; (3) compliance and informational filings adopting an alternate capacity construct, establishing technical "readiness" and discussing results of the annual fixed transmission rights (FTR) allocation process for the Northern Illinois Control Area; and (4) filing by ComEd, AEP and PJM of a service agreement relating to potential loop flow issues affecting Michigan and Wisconsin transmission owners. Following these filings, the commission is expected to issue a final order on integration. Such order could call for an effective integration date of May 1, 2004.

Critical Accounting Policies

Preparation of the financial statements and related disclosures in compliance with generally accepted accounting principles requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. PJM's application of those policies involves judgments regarding many factors, which, in and of themselves, could materially impact the financial statements and disclosures. A future change in the assumptions or judgments applied in determining the following matters, among others, could have a material impact on future financial results: Accounting for Deferred Depreciation and Amortization, Accounting for Deferred FERC Fees, Benefit Plan Accounting and Income Tax Accounting.

Accounting for Deferred Depreciation and Amortization

Deferred depreciation and amortization expense is a result of a rate moderation plan approved by the FERC in July 2000. This asset represents the portion of expenses related to the $104.2 million asset purchase completed in December 2000 that was and will be billed to and recovered from PJM's members from 2003 through 2005.

On November 1, 2003, the FERC approved PJM's request to defer, until January 1, 2005, billing of depreciation related to certain capital costs required to integrate the market integration participants. All such participants are anticipated to be integrated by January 1, 2005. At December 31, 2003, $0.4 million of costs related to the integration was deferred.

Deferred FERC Fees

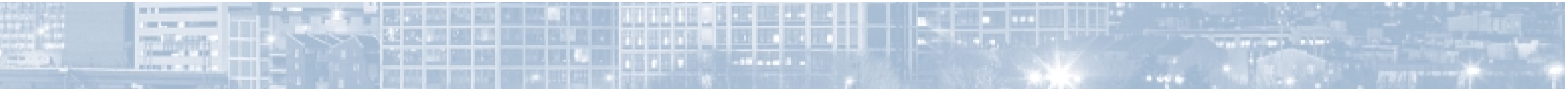
The FERC charges an annual assessment to all public utilities based on kilowatt-hours sold. Deferred FERC fees result from PJM's fixed-rate tariff schedule for the recovery from PJM's members of annual charges from the FERC. On July 29, 2003, PJM received the Annual Charges Billing from the FERC totaling $25.2 million, which reflects charges for the period, October 1, 2002, through September 30, 2003, and an adjustment to the prior year fiscal charge. PJM has billed and collected from its members $19.0 million of its charge and recorded a deferred FERC asset of $6.2 million to reflect the portion of the liability that will be billed to PJM's members during the calendar year 2004.

Benefit Plan Accounting

Based on actuarial calculations, PJM accrues costs of providing future employee benefits in accordance with Statement of Financial Accounting Standards No.87, "*Employers' Accounting for Pensions"* and Statement of Financial Accounting Standards No. 106, "*Employers' Accounting for Postretirement Benefits Other Than Pensions*." Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and those assumed is a guiding principle of these standards. This approach allows for a relatively even recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans.

PJM uses a third-party consultant to assist in evaluating and recording the proper amount for future employee benefits. PJM's ultimate selection of the discount rate, healthcare cost trend rate and expected rate of return on pension assets is based on its review of available current, historical and projected rates, as applicable.

During 2003, PJM made changes to its assumptions related to the discount rate and the healthcare cost trend rate. For the year ended December 31, 2003, PJM decreased the discount rate for its pension and postretirement benefit plans from 6.50 percent to 6.00 percent in view of current market interest rates. In selecting an expected return on plan assets, PJM considered past performance and economic forecasts for the types of investments held by the plans. For the year ended December 31, 2003, PJM retained the expected return on plan assets at 8.00 percent. In selecting healthcare cost trend rates, PJM considers past performance and forecasts of healthcare costs. For the year ended December 31, 2003, PJM decreased its previous healthcare cost trend rates. The previous rates were 13.00 percent for 2002, gradually declining to 5.00 percent over eight years. The new rates are 12.00 percent for 2003, gradually declining to 5.00 percent over eight years. PJM's assumptions listed above could have a significant impact on the accrued pension and other postretirement benefit liabilities and reported annual net periodic pension and other postretirement benefit costs.



During 2003, PJM recognized net periodic pension and other postretirement benefit costs of $ 8.3 million. This amount represents a $3.1 million increase in expense compared to the amount recognized during 2002. This increase was primarily due to increased costs associated with additional employees, changes in actuarial assumptions and a reduction in the actual return on plan assets. See Note 9 to the financial statements for the year ended December 31, 2003, for further information on PJM's benefit plans.

Income Tax Accounting

PJM recognizes income taxes in accordance with the liability method. See Note 8 to the financial statements for the year ended December 31, 2003. PJM believes that sufficient uncertainty exists regarding its ability to realize its deferred income tax assets and has recorded a valuation reserve against these assets. To the extent that management determines that any portion of these deferred income tax assets are realizable, PJM would recognize that change in valuation reserve through income.

Revenues

PJM's total revenues decreased $12.2 million, or 4 percent, to $259.1 million from 2002 to 2003, compared with an increase of $132.5 million, or 95 percent from 2001 to 2002. The primary factor causing the decrease in revenues in 2003 is a decrease in study and interconnection service fees. The primary factors causing the increase in revenues in 2002 were reimbursements for higher operating expenses and an increase in study and interconnection service fees.

Key information systems, system enhancements and improvements launched by PJM in 2003 included:

- Market Systems Backup Center, providing a backup facility, which can be operational within 15 days of a disaster to the market operations systems in the Control Center.
- Market Monitoring System, providing the Market Monitoring Unit with the analysis tools required to efficiently collect and analyze PJM market and operational data, ensuring market behavior and health is effectively monitored in a timely fashion.
- FTR Annual Auction, providing a mechanism for market participants to obtain price certainty when delivering energy across the PJM system.
- FTR Options, providing a new hedging mechanism for market participants.
- Neural Network Net Interchange Schedule Forecasting, providing advanced technologies to the modeling and forecasting of the net interchange schedule of energy within the control areas to which PJM is tied.
- Technology Center leasehold improvements, providing efficiencies of a consolidated workspace for the Information Systems Division, enabling power and communication redundancy.

Expenses

The following table summarizes the percentage of total expenses, excluding study and interconnection services, for the years ended December 31, 2003, 2002 and 2001:

Year Ended December 31,	2003	2002	2001
Compensation expense	30	32	38
Amortization and depreciation expense, net	27	18	7
Outside services	13	16	21
Lease expenses	5	5	6
Software licenses and fees	4	4	5
Pension and postretirement benefit expenses	5	4	3
Computer maintenance and office supplies	3	3	3
Other expense	8	11	8
Interest expense	5	7	9
Income taxes	–	–	–
Total	100%	100%	100%

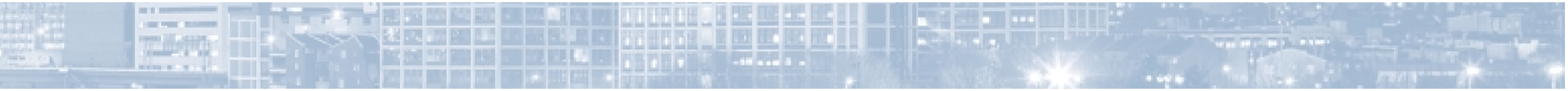
Total operating expenses, excluding study and interconnection services, increased $30.9 million, or 21 percent, to $178.6 million in 2003 as compared to an increase of $46.4 million, or 46 percent, in 2002. The increase in 2003 resulted from the following major factors: (1) a $21.7 million increase in net amortization and depreciation expense due to additional depreciation associated with the $104 million asset purchase in 2000 that was deferred until the years 2003 through 2005; (2) a $4.1 million increase in compensation expense and a $3.1 million increase in retirement plan expenses, both resulting principally from staff additions during 2003 and 2002; and (3) a $1.2 million increase in FERC fees. During 2003, outside services included amounts paid to PJM's independent auditor, PricewaterhouseCoopers LLP, totaling $1.0 million, which were predominantly for audits of the PJM Consolidated Financial Statements and an audit of certain internal control systems in accordance with Statement of Auditing Standards No. 70.

Billings for Services

Membership increased to approximately 250 members at December 31, 2003, as compared to approximately 200 members at December 31, 2002. Within PJM's total membership, its transmission service customers remained at approximately 140 at the end of 2003 and 2002.

For 2003, 2002 and 2001, settlements processed by PJM under the Tariff, Operating Agreement and Reliability Assurance Agreement were as follows:

($ in millions)	2003 Amount Billed	2002 Amount Billed	2001 Amount Billed
Energy Markets	$4,908.5	$3,185.3	$2,141.5
Transmission Congestion	307.9	401.1	208.9
PJM Scheduling, System Control and Dispatch (Operating Expense Reimbursement)	176.4	144.7	94.9
RTO Scheduling, System Control and Dispatch (Transmission Owners' Control Center Expenses)	22.2	22.2	21.1
Reactive Supply	79.3	67.3	59.0
Regulation Market	164.5	140.1	132.3
Spinning Reserve Market	49.9	–	–
Operating Reserves	290.8	239.0	305.0
Black Start Service	5.1	–	–
Network Transmission Service	559.4	369.4	223.1
Point-to-Point Transmission Service	45.2	60.7	49.1
Capacity	27.9	52.5	83.8
Transitional Market Expansion and Revenue Neutrality	27.2	23.1	–
Transmission Losses (Point-to-Point)	16.8	12.9	12.4
FTR Auction Revenues	232.4	16.9	7.4
Mid-Atlantic Energy Council	2.8	2.4	2.8
Distribution Facilities	7.6	6.7	3.5
Ramapo PAR (Phase Angle Regulator) Facilities	1.3	1.3	1.3
Load Response Program	0.7	1.1	–
Unscheduled Transmission Service	0.8	0.8	0.8
Emergency Energy	4.4	–	0.4
Miscellaneous	2.9	1.7	–
Total	$6,934.0	$4,749.2	$3,347.3



Liquidity and Capital Resources

Through December 31, 2003, PJM billed and collected sufficient funds to meet its annual operating expenses. PJM funded its 2003 and 2002 capital needs through working capital generated from operations and borrowings from its $110 million project development facility. PJM recovered amortization and depreciation related to completed projects through charges to all customers via its Tariff. The funds generated from those recoveries are used principally to reduce the principal balances on PJM's long-term debt.

PJM has a five-year, $15 million revolving credit agreement. Additionally, PJM has a $110 million project development facility for which borrowings are collateralized by all of PJM's tangible and intangible property other than the assets acquired pursuant to the Facilities Agreement with a subset of PJM's members. At December 31, 2003, PJM had outstanding borrowings of $76.1 million on the project development facility and no outstanding borrowings on the working capital facility. FERC approval for borrowings under these facilities must be requested biennially. On July 10, 2002, FERC approved borrowing against these two facilities through July 20, 2004. During February 2003, PJM submitted a filing with the FERC requesting approval to increase the limit on the project development facility from $75 million to $110 million and to convert this facility to a revolver. These changes were agreed to by the lender and approved by the FERC on May 1, 2003.

As of December 31, 2003, 2002 and 2001, PJM has been assigned an Aa3 rating according to Moody's Investors Service.

Under the PJM Open Access Transmission Tariff, PJM's transmission provider role is to direct the operation and coordinate the maintenance of the transmission system and indicate, based on studies conducted by PJM, necessary enhancements or modifications to the transmission system. The modifications that are performed on the transmission system, such as network upgrades and generation additions, are conducted principally by transmission owners at the request of a transmission customer. In its system planning capacity as transmission provider, PJM provides billing and collection services in the interconnection service agreement process. For work performed, PJM obtains liquid collateral from the transmission customer for the estimated costs of the modifications.

PJM's interconnection receivables are comprised of billings to transmission customers for services performed under these interconnection service agreements. PJM's interconnection payables represent amounts due to the transmission owners for services performed under these interconnection service agreements. PJM held deposits totaling $18.6 million and $53.9 million at December 31, 2003 and 2002, respectively.

In accordance with PJM's credit policy, PJM requires deposits from various parties in connection with services to be performed or as collateral for market activity. PJM held credit deposits of $65.3 million and $47.8 million at December 31, 2003 and 2002, respectively.

Cash and cash equivalents are derived from cash from operations and cash from financing activities. Net cash provided by operating activities in 2003 was $11.9 million, compared with $49.3 million in 2002. The decrease in cash from operating activities was primarily attributable to a decrease in deposits, receivables and payables.

Net cash provided by financing activities was $28.8 million in 2003 as compared to net cash used in financing activities of $11.2 million in 2002. The $40.0 million net increase in cash provided by financing activities was due primarily to borrowings under PJM's project development facility.

Risks and Uncertainties

PJM does not provide forecasts of future financial performance. While PJM management is optimistic about the Company's long-term prospects, the following issues and uncertainties, among others, should be considered in evaluating its outlook.

Recent Regulatory Actions

On July 12, 2001, the FERC issued an order to commence mediation discussions regarding the formation of a Northeast RTO that would have incorporated the current operating areas of PJM, the New York Independent System Operator, Inc. and ISO New England Inc. On September 22, 2003, the FERC terminated the mediation and formation of a Northeast RTO.

On August 14, 2003, a disturbance on the Eastern Interconnection electric grid caused massive electricity outages in the United States and Canada. The power outage interrupted less than 7 percent of the load on the PJM grid. Affected areas in PJM were northeastern New Jersey and northwestern Pennsylvania. On August 20, 2003, PJM announced its plan to combine a thorough review of events surrounding this outage with an examination of the reliability plans associated with the evolution of energy markets in the Midwestern region. PJM is coordinating with state commissions, the FERC, the U.S. Department of Energy, the North American Electric Reliability Council and its respective regional reliability councils, local control centers and stakeholders to incorporate the applicable lessons learned. On November 14, 2003, the U.S.–Canada Power System Outage Task Force released its interim report on the events of August 14, 2003. At this time, PJM management cannot yet determine the impact these reviews may have on operations or its financial position.

Legislative Activity

From time to time, the United States Congress considers matters pertaining to the restructuring of the electric industry and could revise the existing regulatory scheme and FERC's jurisdiction. It is anticipated that proposed bills will be introduced in Congress during 2004 related to electric industry restructuring and electricity reliability issues.

Third-Party Relationships

PJM engages third parties as suppliers in arrangements to provide services in areas other than core competencies to ensure the service and support of members and timely product development. Although PJM endeavors to establish strong working relationships with parties who share PJM's industry goals and have adequate resources to fulfill their responsibilities, these relationships lead to a number of risks. These suppliers may suffer financial or operational difficulties that may affect their performance, which could lead to delays in product development. Also, major companies from which PJM purchases components or services may be competitors in other areas, which could affect pricing, new product development or future performance. Finally, difficulties in coordinating activities may lead to gaps in delivery and performance of PJM services.

Credit Risks

PJM bills and collects its operating expenses monthly from its members. Payment of all operating expense bills is due from PJM's members by the first business day after the 19th calendar day of the month in which their bills are received. During 2003, in excess of 67 percent of PJM's operating expenses were billed to 19 of its members, each of which has an investment grade credit rating per the Standard & Poor's rating service. In the event of default of any PJM members, the remaining PJM members would be billed a ratable portion of the operating expenses previously billed to the defaulting member.

In accordance with PJM's credit policy, PJM obtains collateral from its members to secure their credit positions. The collateral could be in the form of a cash deposit, letter of credit or corporate guaranty. PJM believes this policy, considered in conjunction with the creditworthiness of its members, addresses the potential risk of a member payment default.

During the first quarter of 2001, two PJM members defaulted on payments totaling approximately $4.5 million. Under the terms of the Operating Agreement, PJM rebilled and collected those amounts from its other member companies. PJM recovered $0.7 million against the defaults, which was subsequently distributed to the members who covered the default. There were no member defaults during 2002 and 2003.

The management of PJM Interconnection, L.L.C. is responsible for the preparation and objectivity of the following consolidated financial statements and for their integrity. These financial statements have been prepared to conform to accounting principles generally accepted in the United States of America and, where required, include amounts that represent management's best judgments and estimates. PJM's management also is responsible for the preparation of other information in this annual report and for its accuracy and consistency with the financial statements.

PJM has established a system of internal accounting and financial controls and procedures designed to provide reasonable assurance as to the integrity and reliability of financial reporting. Management continually examines the effectiveness and efficiency of this system and takes actions when opportunities for improvement are identified.

This system includes a separate Internal Audit Department, which monitors internal controls and reports directly to the Audit Committee of the Board of Managers. Management views the purpose of internal auditing as an independent examination and assessment of PJM's activities related to compliance with policy, procedures and the law, as well as safeguarding of assets. The Audit Committee meets with management and the internal auditors on a regular basis to review financial information, internal controls and the internal audit process.

PJM's independent auditors, PricewaterhouseCoopers LLP, are engaged to conduct an independent audit of PJM's consolidated financial statements in accordance with generally accepted auditing standards.

Phillip G. Harris
President & Chief Executive Officer

Jose Fuentes
Vice President and Chief Financial Officer

To the Board of Managers of
PJM Interconnection, L.L.C.

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of income, comprehensive income and member companies' equity and of cash flows present fairly, in all material respects, the financial position of PJM Interconnection, L.L.C. and its subsidiary (the "Company") at December 31, 2003 and 2002, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Philadelphia, PA
January 30, 2004

($ in thousands)	December 31, 2003	2002
Assets		
Current assets:		
Deposits on hand	$ 87,902	$ 104,411
Operating cash	2,114	4,096
Receivables	17,690	7,838
Interconnection receivables	7,281	11,958
Deferred FERC fees	6,219	–
Prepaid expenses	1,096	1,869
Other	98	821
	122,400	130,993
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of $118,977 and $73,316	80,585	83,665
Projects in development	42,877	27,424
Deferred depreciation and amortization	33,683	35,603
Restricted cash	1,070	2,822
Capitalized financing costs, net of accumulated amortization of $652 and $432	872	1,092
Other	1,280	203
	160,367	150,809
Total assets	$ 282,767	$ 281,802
Liabilities and Member Companies' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 9,579	$ 20,940
Interconnection payables	7,712	13,047
Accrued payroll and benefits	10,996	8,619
Current portion of long-term debt	27,183	26,520
Current portion of long-term project debt	15,051	4,608
Deferred revenue	698	593
Deposits	87,902	104,411
	159,121	178,738
Non-current liabilities:		
Long-term debt	39,338	66,521
Long-term project debt	61,078	17,911
Pension benefits liability	8,353	7,357
Postretirement healthcare benefits liability	11,807	8,443
Other employee benefits	2,026	1,963
	122,602	102,195
Total liabilities	281,723	280,933
Member companies' equity	1,044	869
Commitment and contingencies (Note 10)		
Total liabilities and member companies' equity	$ 282,767	$ 281,802

The accompanying notes are an integral part of these consolidated financial statements.

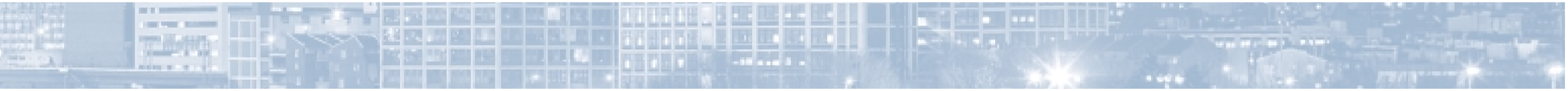
Consolidated Statement of Income, Comprehensive Income and Member Companies' Equity

($ in thousands)	For the Years Ended December 31, 2003	2002	2001
Income			
Revenue:			
Reimbursements	$ 176,404	$143,798	$ 95,399
Study and interconnection fees	80,611	124,471	39,059
Interest income	1,388	2,127	2,033
Membership fees	714	598	560
Other income	26	386	1,801
Total revenue	259,143	271,380	138,852
Operating expenses:			
Study and interconnection services	80,611	123,672	37,577
Compensation	55,160	47,372	38,380
Amortization and depreciation, net of deferral	48,469	26,758	7,344
Outside services	23,084	24,416	20,778
FERC fees	11,033	9,800	2,500
Lease expenses	8,242	6,982	5,956
Software licenses and fees	6,330	6,879	4,708
Pension and postretirement benefits	8,271	5,255	3,220
Computer maintenance and office supplies	6,063	4,197	2,678
Total operating expenses	247,263	255,331	123,141
Other expenses	2,956	5,916	5,907
Interest expense	8,973	10,487	9,424
(Loss) income before income taxes	(49)	(354)	380
Income tax (benefit) expense	–	(402)	332
Net (loss) income	$ (49)	$ 48	$ 48
Other comprehensive income:			
Unrealized gain on securities	224	–	–
Other comprehensive income, net	$ 175	$ 48	$ 48
Member Companies' Equity			
Beginning balance	$ 869	$ 821	$ 773
Net (loss)/income	(49)	48	48
Accumulated other comprehensive income	224	–	–
Ending balance	$ 1,044	$ 869	$ 821

The accompanying notes are an integral part of these consolidated financial statements.

($ in thousands)	2003	2002	2001
	For the Years Ended December 31,		
Cash flows from operating activities			
Net (loss)/income	$ (49)	$ 48	$ 48
Adjustments:			
Amortization and depreciation expense	46,116	38,875	30,830
Deferred depreciation and amortization	1,919	(12,117)	(23,486)
Deferred FERC fees	(6,219)	–	–
Employee retirement benefit expense greater than funding	4,423	4,331	3,411
Deferred tax expense	–	573	–
Changes in assets and liabilities:			
(Increase) decrease in receivables	(9,852)	2,675	(9,894)
Decrease (increase) in interconnection receivables	4,677	(9,829)	(1,944)
(Increase) decrease in prepaid expenses and other	1,652	(972)	3,296
(Decrease) increase in accounts payable and accrued expenses	(11,361)	5,317	4,817
(Decrease) increase in interconnection payables	(5,335)	10,570	2,800
Increase in accrued payroll and benefits	2,377	2,264	1,627
Increase (decrease) in deferred revenue	105	83	(35)
(Decrease) increase in deposits	(16,509)	7,514	70,925
Net cash provided by operating activities	11,944	49,332	82,395
Cash flows from investing activities:			
Cost of projects in development	(58,268)	(35,020)	(31,459)
Purchase of investment	(1,009)	–	–
Net cash used in investing activities	(59,277)	(35,020)	(31,459)
Cash flows from financing activities:			
Borrowings under long-term project debt	66,092	8,273	20,230
Repayments under long-term project debt	(12,482)	(3,945)	(2,039)
Borrowings under line of credit	45,000	17,000	9,000
Repayments under line of credit	(45,000)	(20,000)	(6,000)
Repayments of long-term debt	(26,520)	(14,365)	(3,094)
Use of restricted cash, net of interest earned	1,752	1,819	100
Net cash provided by (used in) financing activities	28,842	(11,218)	18,197
Net (decrease)/increase in cash and cash equivalents	(18,491)	3,094	69,133
Cash and cash equivalents balance, beginning of year	108,507	105,413	36,280
Cash and cash equivalents balance, end of year	$ 90,016	$ 108,507	$ 105,413
Cash paid during the year for:			
Interest	$ 7,832	$ 9,971	$ 9,624
Income taxes	–	–	–

The accompanying notes are an integral part of these consolidated financial statements.



1. Company Overview

Background

PJM Interconnection, L.L.C. (PJM or Company) is responsible for the operation of wholesale electric markets and for centrally dispatching electric systems in the PJM region. The Federal Energy Regulatory Commission (FERC) issued an order on December 19, 2002, ruling PJM qualified for full regional transmission organization (RTO) status and designating PJM as the sole RTO for the PJM region. PJM's services and the markets PJM operates are subject to regulation by the FERC.

PJM is a limited liability, non-stock company incorporated in the state of Delaware. PJM's Board of Managers is constituted as an independent body, and PJM operates independently from its members.

Nature of Operations

The Company currently coordinates a pooled generating capacity of more than 76,000 megawatts and operates a wholesale electricity market with more than 250 market buyers, sellers and traders of electricity. PJM enables the delivery of electric power to more than 25 million people in all or parts of Delaware, Maryland, New Jersey, Ohio, Pennsylvania, Virginia, West Virginia and the District of Columbia.

In addition to ensuring the reliable supply of electricity, PJM administers Internet-based bid markets in which participants buy and sell spot market energy, capacity credits, fixed transmission rights, spinning reserves and regulation services. PJM provides accounting, billing and collection services for these transactions. PJM also directs the pooled operation of approximately 350 million annual megawatt-hours of electric power, of which approximately 100 million megawatt-hours are exchanged through the electric energy markets.

PJM Technologies, Inc. (PJM Tech) is a wholly owned subsidiary of PJM and is not a FERC-regulated entity. PJM Tech was formed to provide service and technology solutions pioneered by PJM to existing and emerging energy markets, system operators and regional transmission organizations.

On March 14, 2001, PJM entered into agreements with Allegheny Power, the energy delivery business of Allegheny Energy, Inc., to develop a new electric transmission system affiliation that expanded PJM's existing region to the west. Operations in the PJM Western Region commenced on April 1, 2002.

On August 14, 2001, Duquesne Light Company (Duquesne) announced its intention to join the PJM Western Region arrangements during 2002. During the third quarter of 2002, Duquesne announced it planned to defer a final decision on joining an RTO until it completed analysis of the FERC's proposed order on standard market design. On December 9, 2003, Duquesne filed a plan before the Pennsylvania Public Utility Commission expressing its intent to join PJM by January 1, 2005.

On January 21, 2002, PJM and the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) announced an executed letter of intent to develop a joint and common market for electricity producers and consumers in all or part of 22 Midwest and Mid-Atlantic states, the District of Columbia and the Canadian province of Manitoba.

On May 13, 2002, PJM and the Midwest ISO executed a memorandum of cooperation (MOC) to facilitate the implementation of a joint and common market in the Midwest. The MOC outlines a collaborative process to identify and address issues that will allow for a more efficient transition to a joint and common energy market. The market is being developed through an open, stakeholder process and is being designed to serve residents whether they reside in states with bundled or unbundled retail rates.

In June 2002, American Electric Power (AEP); Commonwealth Edison (ComEd), a subsidiary of Exelon Corporation; Dayton Power & Light Company (DPL); and Illinois Power, a subsidiary of Dynegy, announced their intent to join PJM as an extension of the PJM Western Region, subject to regulatory and governmental approvals. Illinois Power no longer intends to join PJM.

In June 2002, Dominion Virginia Power (DVP) and PJM announced that the companies had executed an agreement to have Dominion's transmission lines operated on a regional basis by PJM. During the first quarter of 2003, the Virginia Legislature passed a law barring Virginia utilities, which include AEP and DVP, from turning over control of their transmission lines to RTOs before July 1, 2004, but requiring them to transfer control of their transmission lines to a "regional entity" by January 1, 2005, subject to the approval of the Virginia State Corporation Commission. AEP also requires approval from the Indiana Utility Regulatory Commission and the Kentucky Public Service Commission.

On November 25, 2003, the FERC issued an order preliminarily finding that Kentucky and Virginia state laws or regulations are preventing AEP from joining PJM and should be preempted. The FERC ordered an expedited evidentiary hearing, with an initial decision due by March 31, 2004, on this issue.

On July 31, 2002, the FERC conditionally approved the requests of AEP, ComEd, DPL and DVP (collectively, the market integration participants) to join PJM. The FERC's conditions for joining include resolution of certain operational and transmission rate matters to be approved by the FERC prior to the market integration participants' entry into PJM.

Implementation agreements were executed during October 2002 with the market integration participants. These agreements express the companies' plans for their phased integration into PJM's operations and markets, subject to certain regulatory and governmental approvals. As of December 31, 2003, PJM capitalized $46 million in costs associated with the addition of the market integration participants. All integration expenses will be borne by the market integration participants.

On April 16, 2003, the Midwest ISO, PJM and the Tennessee Valley Authority (TVA) announced plans to pursue the development of a multiregional approach to strengthen electric transmission, operations and related transactions. The memorandum of understanding executed by the three organizations initiates the first step of a process that would, when complete, facilitate a transparent market for a significant portion of the Eastern Interconnection. The Eastern Interconnection refers to North America's electric system east of the Rocky Mountains, excluding Texas.

In June 2003, PJM began providing third-party administrative services dealing with transmission functions under the existing ComEd and DPL Open Access Transmission Tariffs.

On December 31, 2003, the Midwest ISO and PJM executed and filed with the FERC a joint operating agreement. The agreement is the foundation by which the Midwest ISO and PJM will create seamless operations to serve wholesale electricity customers in 22 states, the District of Columbia and parts of Canada.

On December 31, 2003, PJM requested that the FERC approve May 1, 2004, as ComEd's integration date. PJM also continues to work toward market integration commencing on October 1, 2004, for AEP and DPL and November 1, 2004, for DVP.

On March 18, 2004, the FERC issued four orders in response to PJM filings seeking to meet previously established FERC conditions necessary to accommodate ComEd's integration into PJM. These orders conditionally approved most elements required to implement ComEd's integration. The commission, however, directed certain other actions to occur prior to integration. Principal among such actions are: (1) the North American Reliability Council's approval of the reliability plans of PJM and Midwest ISO; (2) the filing of revisions to the Joint Operating Agreement between PJM and MISO; (3) compliance and informational filings adopting an alternate capacity construct, establishing technical "readiness" and discussing results of the annual FTR allocation process for the Northern Illinois Control Area; and (4) filing by ComEd, AEP and PJM of a service agreement relating to potential loop flow issues affecting Michigan and Wisconsin transmission owners. Following these filings, the commission is expected to issue a final order on integration. Such order could call for an effective integration date of May 1, 2004.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared on an accrual basis in accordance with accounting principles generally accepted in the United States of America and include the accounts of PJM and its wholly owned subsidiary. All intercompany transactions and balances have been eliminated.

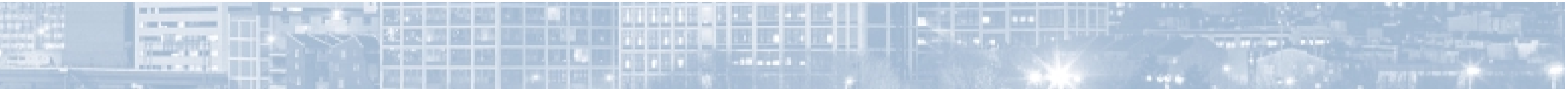
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying disclosures. Those estimates are based on management's best knowledge of current events and actions the company may undertake in the future. Actual results may ultimately differ from estimates.

Cash Equivalents

Highly liquid investments with maturities of three months or less when purchased are considered cash equivalents.

Concentration of Credit Risk

Financial instruments that subject PJM to credit risk consist primarily of accounts receivable relating to monthly operating expense billings. As provided in PJM's Operating Agreement, members are required to maintain either approved credit ratings or to post specified financial securities to obtain credit within the PJM



markets. During 2003, 67 percent of PJM's operating expenses were billed to 19 of its members, each of which has an investment-grade credit rating according to the Standard & Poor's rating service.

Fixed Assets

PJM's fixed assets are comprised principally of software and capitalized software development costs, leasehold improvements and computer hardware. The costs incurred to acquire and develop computer software for internal use, including financing costs, are capitalized. Costs incurred prior to the determination of feasibility of developed software and following the in-service date of developed software are expensed. Fixed assets are depreciated or amortized using the straight-line method over the useful lives of the assets as follows:

Software and capitalized software development costs	3 to 7 years
Computer hardware	3 years
Leasehold improvements	10 years

Deferred Depreciation and Amortization

Deferred depreciation and amortization expense is a result of a rate moderation plan approved by the FERC in July 2000. This asset represents the portion of expenses related to the $104.2 million asset purchase completed in December 2000 that was and will be billed to and recovered from PJM's members from 2003 through 2005.

On November 1, 2003, the FERC approved PJM's request to defer until January 1, 2005, billing of depreciation related to certain capital costs required for market integration. Those costs will be billed to all members after January 1, 2005. All such participants presently are anticipated to be integrated by January 1, 2005. At December 31, 2003, $0.4 million of capital costs related to the integration were deferred.

Deferred FERC Fees

The FERC charges an annual assessment to all public utilities based on kilowatt-hours sold. Deferred FERC fees result from PJM's fixed-rate tariff schedule for the recovery from PJM's members of annual charges from the FERC. On July 29, 2003, PJM received the Annual Charges Billing from the FERC totaling $25.2 million, which reflects charges for the period October 1, 2002, through September 30, 2003, and an adjustment to the prior year fiscal charge. PJM has billed and collected from its members $19.0 million of its charge and recorded a deferred FERC asset of $6.2 million to reflect the portion of the liability that will be billed to PJM's members during the calendar year 2004.

Interconnection Activity

Under the PJM Open Access Transmission Tariff (the Tariff), PJM's transmission provider role is to direct the operation and coordinate the maintenance of the transmission system and indicate, based on studies conducted by PJM, necessary enhancements or modifications to the transmission system. The modifications that are performed on the transmission system, such as network upgrades and generation additions, are conducted principally by transmission owners at the request of a transmission customer. In its system planning capacity as transmission provider, PJM provides billing and collection services in the interconnection service agreement process. For work performed, PJM obtains liquid collateral from the transmission customer for the estimated costs of the modifications. PJM's interconnection receivables are comprised of billings to transmission customers for services performed under these interconnection service agreements. PJM's interconnection payables represent amounts due to the transmission owners for services performed under these interconnection service agreements.

Deferred Revenue

PJM membership fees, billed and collected in advance of the year for which they apply, are amortized ratably over the related annual membership period.

Deposits

At December 31, 2003, the deposits balance was comprised of $18.6 million received for interconnection studies and fees, $65.3 million held by PJM to support customer credit and $4.0 million received from market integration participants. At the end of 2002, PJM held deposits of $53.9 million for interconnection studies, $47.8 million for customer credit and $2.7 million from market integration participants.

Income Taxes

PJM has elected to be taxed as a corporation. Certain income and expense items primarily relating to the treatment of software development costs, pension, postretirement healthcare and other employee benefits are accounted for in different time periods for financial reporting than for income tax reporting purposes. Deferred income taxes have been provided on the difference between the tax bases of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates anticipated to be in effect when such temporary differences are expected to reverse. Valuation allowances are provided to the extent that the realization of deferred tax assets is not likely. During the third quarter of 2002, the company increased its valuation allowance so as to reserve fully its deferred tax assets because it is not likely that the deferred tax assets will be realized.

Fair Values of Financial Instruments

The carrying amounts reported in the Consolidated Statement of Financial Position for current assets and liabilities approximate their fair values.

Benefit Plan Accounting

Based on actuarial calculations, PJM accrues costs of providing future employee benefits in accordance with Statement of Financial Accounting Standards No. 87, "*Employers' Accounting for Pensions*" (FAS 87) and Statement of Financial Accounting Standards No. 106, "*Employers' Accounting for Postretirement Benefits Other Than Pensions*." Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and those assumed is a guiding principle of these standards. This approach allows for a relatively even recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans.

PJM uses a third-party consultant to assist in evaluating the proper amount for future employee benefits. PJM's ultimate selection of the discount rate, health-care cost trend rate and expected rate of return on pension assets is based on its review of available current, historical and projected rates, as applicable.

Derivatives

PJM has not engaged in any derivative financial transactions.

Revenue Recognition

PJM recognizes as revenue amounts both billed and unbilled for which PJM has incurred costs as of the period end and has the authority to be reimbursed under the Tariff, Operating Agreement, Reliability Assurance Agreement or Mid-Atlantic Area Council (MAAC) Agreement.

Interconnection revenues are recognized when PJM is entitled to receive payment for interconnection activity from the transmission customer. These revenues are offset by the corresponding interconnection expenses for payment of this activity.

3. Accounts Receivable

PJM's receivables at December 31, 2003 and 2002, consisted of the following (amounts in thousands):

	2003	2002
Billed:		
Membership fees	$ 121	$ 232
	121	232
Unbilled:		
Operating expenses	17,346	7,469
MAAC and other	223	137
	17,569	7,606
Receivables	$ 17,690	$ 7,838

All interconnection receivables were billed at December 31, 2003 and 2002.

PJM's member companies are billed on a monthly basis for the preceding month's operating expenses. PJM bills members for the services each uses under seven distinct service categories.

4. Fixed Assets and Projects in Development

A summary of fixed assets by classification as of December 31, 2003 and 2002, is as follows (amounts in thousands):

	2003	2002
Leasehold improvements	$ 9,605	$ –
Software development	159,835	133,349
Computer hardware	29,370	23,632
Furniture and fixtures	752	–
Subtotal	199,562	156,981
Accumulated depreciation	(118,977)	(73,316)
Total fixed assets, net of accumulated depreciation	80,585	83,665
Projects in development	42,877	27,424
Total	$ 123,462	$ 111,089

Amortization of software development costs for the years ended December 31, 2003 and 2002, were $38.7 million and $33.1 million, respectively.

5. Short-Term Debt

PJM has a $15 million revolving credit agreement with National Cooperative Services Corporation (NCSC). The revolving credit agreement has a five-year term, is unsecured and is available to fund temporary cash flow needs. FERC approval for borrowings under this facility must be requested biennially. On July 10, 2002, the FERC approved borrowing against this facility through July 20, 2004.

As of December 31, 2003 and 2002, there were no outstanding borrowings under the working capital facility. The interest rate on borrowings under this revolving credit agreement is based on NCSC's variable interest rate. The rate can change effective the first or 16th of any month. The weighted average rate was 3.66 percent and 4.65 percent at December 31, 2003 and 2002, respectively.

6. Long-Term Debt

On December 19, 2000, PJM issued senior notes with a seven-year term totaling $110.5 million. These notes bear interest at 7.163 percent per annum. Payments are due semi-annually on June 15 and December 15. In order to compensate for the timing difference between when the semi-annual note payments are due and when PJM's members remit their monthly settlement, PJM deposited $4.7 million of the proceeds in a trustee account. Through December 31, 2003, PJM had used $3.6 million of this restricted cash to pay portions of its semi-annual senior note payments. The remaining balance of $1.1 million has been classified as restricted cash in the Consolidated Statement of Financial Position.

PJM incurred a total of $1.5 million in closing costs to obtain this financing. These costs have been capitalized and are being amortized on a straight-line basis over the seven-year term of the notes.

Repayments of principal under PJM's senior notes to be funded by payments for depreciation charges from its members in accordance with the Tariff are scheduled as follows (amounts in thousands):

Year Ending December 31,	Senior Notes
2004	$ 27,183
2005	23,426
2006	10,056
2007	5,856
Total	$ 66,521

7. Long-Term Project Debt

On July 21, 2000, the FERC approved PJM's application to enter into a $75 million project development facility with NCSC. This facility is available for asset development, has a four-year drawdown period with a 10-year amortization period and is collateralized by all of PJM's tangible and intangible property other than the assets acquired pursuant to the agreement (the Facilities Agreement) between PJM and a subset of PJM's members (the Facility Owners). FERC approval for borrowings under this facility must be requested biennially. On July 10, 2002, the FERC approved borrowing against this facility through July 20, 2004. During February 2003, PJM submitted a filing with the FERC requesting approval to increase the limit on the project development facility to $110 million and to convert this facility to a revolver. These changes were agreed to by the lender and approved by the FERC on May 1, 2003.

As of December 31, 2003 and 2002, outstanding borrowings under the project development facility were $76.1 million and $22.5 million, respectively. The interest rate on these borrowings is based on NCSC's variable interest rate. The rate can change effective the first or 16th of any month. The interest rate on these borrowings at December 31, 2003 and 2002, was 3.20 percent and 4.05 percent, respectively.

Repayments of principal under PJM's project development facility that are to be funded by depreciation charges to its members in accordance with the Tariff are scheduled as follows (amounts in thousands):

Year Ending December 31,	Project Development Facility
2004	$ 15,051
2005	9,811
2006	565
Other*	50,702
Total	$ 76,129

** Timing of remaining payments will be determined when assets are placed into service.*

8. Income Taxes

PJM recognizes income taxes in accordance with the liability method.

The liability method requires that deferred income tax assets be reduced by a valuation allowance if it is more likely than not that portions or all of the deferred income tax assets will not be realized. PJM believes sufficient uncertainty exists regarding the realizability of certain deferred income tax assets to warrant a valuation allowance on those items.

Income tax (benefit) expense shown on the Consolidated Statement of Income and Member Companies' Equity consisted of the following (amounts in thousands):

	2003	2002	2001
State income taxes:			
Current	$ –	$ (2)	$ 8
Deferred	65	(56)	(222)
Valuation allowance	(65)	56	222
	–	(2)	8
Federal income taxes:			
Current	–	(974)	324
Deferred	174	787	(342)
Valuation allowance	(174)	(213)	342
	–	(400)	324
Income tax (benefit) expense	$ –	$ (402)	$ 332

The effects of temporary differences giving rise to deferred income tax assets at December 31, 2003 and 2002, consisted of the following (amounts in thousands):

	2003	2002
Deferred tax assets:		
Pension	$ 3,862	$ 3,811
Postretirement healthcare	5,259	3,715
Net operating loss carryforwards	39,132	30,646
Accrued expenses	780	837
	49,033	39,009
Deferred tax liabilities:		
Fixed assets	(47,639)	(37,257)
Other benefits	235	116
	(47,404)	(37,141)
Total deferred income taxes	1,629	1,868
Valuation allowance	(1,629)	(1,868)
Deferred income taxes, net	$ –	$ –

The income tax rate on PJM's operating activities differed from the federal statutory rate as follows (amounts in thousands):

	2003	2002	2001
Income tax at the 34% federal statutory rate	$ (17)	$ (120)	$ 129
Increase (decrease) resulting from:			
Change in valuation allowance	(174)	(213)	342
Meals and entertainment	107	70	
Net operating loss benefit	83	(162)	
State income taxes, net of federal tax benefit	–	(1)	6
Other	1	24	(144)
Income tax (benefit) expense	$ –	$ (402)	$ 333

PJM has operating loss carryforwards of $87.1 million and $95.4 million, respectively, for federal and Pennsylvania state tax purposes. The federal and state carryforwards expire in 2023.

During the third quarter of 2002, PJM recorded a federal tax refund of $0.9 million resulting from changes in tax statutes that allowed PJM to carryback a deduction for project development costs to the 1997 through 1999 tax periods. Also, during the third quarter of 2002, the company increased its valuation allowance so as to reserve fully its deferred tax assets because it is more likely than not that the deferred tax assets will not be realized.

9. Benefit Plans

Pension Plan

PJM sponsors a defined benefit pension plan (the plan), which covers all full-time employees. Benefits under the plan are based on years of service and the employee's compensation. PJM's contribution to the plan is determined according to the funding requirements set forth by the Employee Retirement Income Security Act of 1974. Plan assets are invested primarily in stocks and bonds and are monitored by PJM's Benefits Administration Committee.

Supplemental Executive Retirement Plan

PJM also sponsors a Supplemental Executive Retirement Plan (SERP) to provide certain members of senior management with benefits in excess of normal pension benefits. At December 31, 2003 and 2002, the actuarially computed benefit obligation of the SERP amounted to $2.2 million and $1.9 million, respectively. SERP expense for this plan was $0.3 million, $0.3 million and $0.4 million for the years ended December 31, 2003, 2002 and 2001, respectively. The accrued SERP costs included in the other employee benefits liability at December 31, 2003 and 2002, were $1.4 million and $1.2 million, respectively. The SERP is not funded. However, PJM intends to use the proceeds from an investment of $1.0 million in equity securities that was made in January 2003 to settle its obligations under the SERP. The investment is included in other non-current assets at December 31, 2003.

Postretirement Benefits

PJM provides certain healthcare and other benefits to retired employees and their spouses. Substantially all of PJM's employees may become eligible for these benefits provided they have been credited with at least five years of service or 10 years in the case of early retirement at the age of 55. PJM elected to amortize, over a 20-year period, the transition obligation resulting from the adoption of Statement of Financial Accounting Standards No. 106, "*Employers' Accounting for Postretirement Benefits Other than Pensions*," which was $3.4 million as of January 1, 1995.

The schedules that follow show the change in the benefit obligations, plan assets and funded status as of December 31, 2003 and 2002, and components of net periodic pension and postretirement healthcare costs of these plans for the years ended December 31, 2003, 2002 and 2001 (amounts in thousands).

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2003	2002	2003	2002	2003	2002
CHANGE IN BENEFIT OBLIGATION						
Net benefit obligation at beginning of year	$ 45,150	$ 37,239	$ 1,854	$ 2,039	$ 17,015	$ 14,482
Service cost	3,090	2,219	90	95	1,897	1,287
Interest cost	2,957	2,564	122	123	1,179	937
Plan participants' contributions (estimated)	–	–	–	–	22	24
Plan amendments	467	169	19	–	–	–
Actuarial (gain)/loss	5,809	4,637	164	(401)	4,543	444
Gross benefits paid	(825)	(1,678)	(6)	(2)	(169)	(159)
Net obligation at end of year	$ 56,648	$ 45,150	$ 2,243	$ 1,854	$ 24,487	$ 17,015

PJM uses a measurement date of December 31 for all of its pension and postretirement benefit plans.

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2003	2002	2003	2002	2003	2002
CHANGE IN PLAN ASSETS						
Fair value of plan assets at beginning of year	$ 25,888	$ 29,576	$ –	$ –	$ –	$ –
Actual return on plan assets	5,840	(3,077)	–	–	–	–
Employer contributions	3,623	1,067	6	2	148	135
Plan participants' contributions	–	–	–	–	21	24
Gross benefits paid	(825)	(1,678)	(6)	(2)	(169)	(159)
Fair value of plan assets at end of year	34,526	25,888	–	–	–	–
Funded status at end of year	(22,122)	(19,262)	(2,243)	(1,854)	(24,487)	(17,015)
Unrecognized net actuarial (gain)/loss	12,720	11,212	1,292	1,256	11,485	7,235
Unrecognized prior service cost	1,049	693	(519)	(639)	514	594
Unrecognized net transition obligation (asset)	–	–	37	43	681	743
Net amount recognized at end of year and amounts recognized in the statement of financial position	$ (8,353)	$ (7,357)	$ (1,433)	$ (1,194)	$ (11,807)	$ (8,443)

At the end of 2003 and 2002, the projected benefit obligation, the accumulated benefit obligation and the fair value of pension plans with a projected benefit obligation in excess of plan assets and for pension plans with an accumulated benefit obligation in excess of plan assets were as follows (amounts in thousands):

	Projected Benefit Obligation Exceeds the Fair Value of Plan Assets				Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets			
	Qualified		SERP		Qualified		SERP	
	2003	2002	2003	2002	2003	2002	2003	2002
End of Year								
Projected benefit obligation	$ 56,648	$ 45,150	$ 2,243	$ 1,854	$ 56,648	$ 45,150	$ 2,243	$ 1,854
Accumulated benefit obligation	39,478	31,862	1,217	940	39,478	31,861	1,217	940
Fair value of plan assets	34,526	25,888	–	–	34,526	25,888	–	–

The accumulated postretirement benefit obligation was $24.5 million and $17.0 million at December 31, 2003 and 2002, respectively. There were no plan assets for PJM's other postretirement benefit plan.

On December 8, 2003, the Medicare Drug, Improvement and Modernization Act of 2003 (the Act) was passed, which introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In January 2004, the FASB issued Staff Position (FSP) 106-1, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, which permits a sponsor of a postretirement healthcare plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Act. In accordance with the Act, any measures of the accumulated postretirement benefit obligation (APBO) or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the Company's postretirement plans. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require changes to previously reported information.

Expected Cash Flows

Information about expected cash flows for the pension and postretirement benefit plans follows (amounts in thousands):

	Qualified Benefits	SERP Benefits	Other Benefits
Employer Contributions			
Expected employer contributions for 2004 to plan trusts	$ 10,367	N/A	N/A
Expected employer contributions in form of direct benefit payments for 2004	–	$ 7	$ 219
Expected Benefit Payments			
2004	897	7	219
2005	946	7	309
2006	998	8	400
2007	1,053	8	498
2008	1,111	8	606
2009-2013	6,541	50	4,993

The above table reflects the benefits expected to be paid from the plan or from PJM's assets for PJM's share of the benefit cost. The participants' share of the cost, which is funded by participant contributions to the plan, is not included in this table. Expected contributions to plan trusts reflect expected required amounts to be contributed to the fund.

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2003	2002	2003	2002	2003	2002
COMPONENTS OF NET PERIODIC BENEFIT COST						
Service cost	$ 3,090	$ 2,219	$ 90	$ 95	$ 1,897	$ 1,287
Interest cost	2,957	2,564	122	123	1,179	937
Expected return on assets	(2,065)	(2,321)	–	–	–	–
Amortization of:						
Transition obligation (asset)	–	–	6	6	62	62
Prior service cost	112	82	(100)	(103)	80	80
Actuarial (gain) loss	526	–	127	182	293	277
Total net periodic benefit cost	$ 4,620	$ 2,544	$ 245	$ 303	$ 3,511	$ 2,643

For the years ended December 31, 2003, 2002 and 2001, respectively, $0.7 million, $0.6 million and $0.4 million of total pension and postretirement benefits expense have been included in capitalized project costs.

The following schedule shows the assumptions used to calculate the pension and postretirement benefit obligations as of December 31, 2003, 2002 and 2001.

	Pension Benefits			Postretirement Benefits		
	2003	2002	2001	2003	2002	2001
Discount rate	6.00%	6.50%	7.00%	6.00%	6.50%	7.00%
Expected return on plan assets	8.00%	8.00%	8.00%	N/A	N/A	N/A
Rate of compensation increase	5.50%	5.50%	5.50%	N/A	N/A	N/A
Medical Trend						
Current				12.00%	13.00%	14.00%
Ultimate				5.00%	5.00%	5.00%
Years to Ultimate				8	8	9

The effect of a 1 percent increase in the assumed healthcare cost trend rate from 12 percent to 13 percent would increase the postretirement benefit obligation as of December 31, 2003, by $5.4 million and the current year postretirement benefit cost by approximately $0.9 million. A 1 percent decrease in the assumed healthcare cost trend rate from 12 percent to 11 percent would decrease the accumulated postretirement benefit obligation by approximately $4.2 million and would decrease the postretirement benefit cost by approximately $0.6 million annually.

Savings Plan

PJM also contributes to a 401(k) savings plan (the savings plan) for all eligible employees of the company who have completed six months of service. The savings plan permits employees to contribute up to 15 percent of their gross compensation on a pretax basis, subject to limitations as described in the savings plan. PJM makes matching contributions equal to 100 percent of the employee's first 5 percent contributed. PJM contributions to the savings plan were approximately $1.6 million, $1.3 million and $1.0 million for the years ended December 31, 2003, 2002 and 2001.

10. Commitments and Contingencies

Leases

PJM leases office space, furniture and computer and copier equipment under operating leases with various vendors. These leases are noncancelable and expire during the period from 2004 to 2007.

Future minimum rentals under noncancelable lease agreements are as follows:

Year Ending December 31,	
2004	$ 3,412
2005	1,581
2006	1,027
2007	762
2008	785
Remaining	3,811
Total	$11,378

Regulatory Items

On July 12, 2001, the FERC issued an order to commence mediation discussions regarding the formation of a Northeast RTO that would have incorporated the current operating areas of PJM, the New York Independent System Operator, Inc. and ISO New England Inc. On September 22, 2003, the FERC terminated the mediation and formation of a Northeast RTO.

On August 14, 2003, a disturbance on the Eastern Interconnection electric grid caused massive electricity outages in the United States and Canada. The power outage interrupted less than 7 percent of the load on the PJM grid. Affected areas in PJM were northeastern New Jersey and northwestern Pennsylvania. On August 20, 2003, PJM announced its plan to combine a thorough review of events surrounding this outage with an examination of the reliability plans associated with the evolution of energy markets in the Midwestern region. PJM is coordinating with state commissions, the FERC, the U.S. Department of Energy, the North American Electric Reliability Council and its respective regional reliability councils, local control centers and stakeholders to incorporate the applicable lessons learned. At this time, PJM management cannot yet determine the impact these reviews may have on operations or its financial position.

Legal

PJM is routinely involved in regulatory proceedings. In the opinion of management, none of these matters will have a material adverse effect, if any, on the financial position, results of operations or liquidity of PJM.

11. Related Party Transactions

PJM occupies two buildings that are owned by the Facilities Owners. One of the buildings was purchased in 1992 at a cost of $2.9 million. This building was subsequently renovated at a cost of $2.9 million. A second building occupied by PJM and used as the PJM Control Center was purchased in July 1995 at a cost of $4.8 million. Through December 31, 2000, the Facilities Owners elected not to charge PJM rent for the use of these facilities. Effective January 1, 2001, PJM commenced paying a nominal rent of two dollars per year for the use of these facilities. PJM is responsible for facility maintenance, property taxes, insurance and other related costs associated with these two buildings. Estimated annual market rent for these two buildings is approximately $1.6 million.

In accordance with PJM's policies, PJM allows for cash advances to relocating employees. There were no advances outstanding at December 31, 2003 or 2002, respectively.

PJM RTO Load: 42,663MW
PJM members
eData Preferences
Guest1
eData
PJM (Zone)
39.40
26.70
44.59
LMP Chart
Into PJM
1,632
190
-415
2,876
4,283
Out of PJM
Scheduled
Actual
Tie Flows
MegaWatts
Price in US$
08
09
10